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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 725

RALPH R. ANDERSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 726

HERBERT R. ANDERSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 79–89) is reported at 5 T. C. 443. The opinion of the Circuit Court of Appeals (R. 139–145) is reported at 164 F. 2d 870.[1]

[1] The cases were consolidated for hearing before the courts below. (R. 79, 127, 139.)

JURISDICTION

The judgments of the Circuit Court of Appeals were entered December 17, 1947. (R. 145–146.) Taxpayers' petition for rehearing was denied January 9, 1948. (R. 147.) The petition for writs of certiorari was filed April 8, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that taxpayers remained the substantial owners of shares of stock transferred of record to members of their families, and that the income from such shares was accordingly includible in taxpayers' gross incomes as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, divi-

dends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (26 U. S. C. 22.)

STATEMENT

The material facts found by the Tax Court (R. 80–87)[2] may be summarized as follows:

In 1937, taxpayers Herbert and Ralph Anderson, brothers, owned respectively 388 and 360, or a total of 748, of the 750 outstanding shares of stock of Robert R. Anderson Company. Herbert was married and had a son 14 years of age. Ralph had 3 children (14, 8, and 7 years of age) by his first wife, and remarried in 1939. (R. 80.)

On December 1, 1937, taxpayers through simultaneous transfers caused some of their shares to be transferred on the corporate books to members of their families. As a result, Herbert's wife and child became record owners of a total of 68 shares, corresponding to the number transferred by him; while Ralph's children became the record owners of a total of 85 shares, corresponding to the number transferred by him. The new certificates were placed in a safe of the company in the care of one Christiansen, the secretary of the company, with the knowledge and consent of the

[2] The Tax Court's findings were amended by its order (R. 100–102) entered upon taxpayers' Motion for Rehearing and Reconsideration (R. 91–100). The statement incorporates these amendments.

donees, who were fully apprised of the transfers. Christiansen placed the certificates in envelopes bearing the names of the donees. Ten days after the transfer a dividend of $25 per share was declared on the stock, and on the same day taxpayers borrowed the dividends from the transferees and executed in exchange 6% demand notes which were also kept in the office of the company. (R. 81–82, 101.)

On April 1, 1938, taxpayers caused more of their shares to be similarly transferred on the corporate books and the new certificates to be placed with the others. As a result, the record ownership of Herbert's wife and child was increased to a total of 140 shares, corresponding to the total number transferred by him; while the record ownership of Ralph's children was increased to a total of 175 shares, corresponding to the total number transferred by him. (R. 82.) A few days later another dividend of $25 per share was declared, which taxpayers again borrowed from the transferees in exchange for 6% demand notes which were placed in the company safe. (R. 82–83.)

On April 15, 1939, taxpayers caused additional shares to be similarly transferred and the new certificates to be placed in the company safe with the others. The record ownership of Herbert's wife and child was thereby increased to a total of 228 shares, corresponding to the total number theretofore transferred by him; while the record

ownership of Ralph's children and second wife was increased to a total of 307 shares, corresponding to the total number theretofore transferred by him. (R. 83.) Two weeks later a dividend of $50 per share was declared, taxpayers again borrowed the dividends from the transferees, and again executed 6% demand notes which were placed in the company safe. (R. 83–84.)

No interest was paid on any of the notes given for the borrowed dividends. On December 31, 1941, taxpayers each executed new 6% demand notes for the amount of interest then due. Each taxpayer devoted the dividends he borrowed to his own business or personal use, though not for the support or maintenance of his wife or children. Some of the dividend checks were endorsed by taxpayers or by Christiansen in the names of the payees. (R. 84.)

After the transfers taxpayers continued to manage and direct the affairs of the corporation in the same manner as before. No formal stockholders' meetings were held after the transfers until November 9, 1940. (R. 85).

In 1940 taxpayers decided to convert the business from a corporation to a partnership. With the consent of all the members of the family it was arranged that taxpayers and their wives would acquire the stock standing in the names of the children in such proportions that each would own one-fourth of the stock, in exchange for notes to the children. Accordingly, on No-

vember 19, 1940, transfers were made on the corporate books placing the entire outstanding stock in the names of taxpayers and their wives in equal amounts of 187½ shares each, and taxpayers and their wives executed 6% demand notes to the children in amounts based on the book value of the shares. These notes were likewise placed in the company safe. It was understood that when the sons reached 25 or finished school they could use the notes or proceeds to purchase an interest in the partnership, while the daughter would receive one-half of the amount of her note when she reached 25 or married and the other half when she reached 30. A partial liquidation distribution was made before the end of 1940, and the liquidation was completed in 1941. On December 31, 1941, additional notes were given to the children in the amounts of the unpaid interest and were placed in the safe with the others. At the same time taxpayers took credits against the principal of the notes for income tax payments and investments made on behalf of the children, these credits being acknowledged in most instances by appropriate endorsement on the notes. (R. 85–86, 101.)

In 1941 taxpayers decided to create trusts for the children, the corpora to consist of the various notes which had been executed and were still in the company safe. They caused a trust agreement to be prepared, naming their brother-in-law as trustee, and instructed Christiansen to destroy

the old notes and substitute new ones payable to the trustee. The new notes were prepared, but the old ones were never destroyed. The trust agreement was executed January 2, 1942, but when the trustee later inquired about payment of interest on the new notes he was informed that the trust agreement was void and would be cancelled on the advice of taxpayers' attorney. The trust agreement was marked "void" and returned to taxpayers with the new notes. (R. 87.)

The dividends on the transferred shares were reported as the income of the wives and children. The taxes were paid on their behalf by taxpayers. (R. 84, 89.) The Commissioner determined that the transfers were without federal income tax effect and included in taxpayers' gross incomes for 1939 the dividends paid in that year on the transferred shares, resulting in the 1939 deficiencies in controversy. (R. 15, 28.) The Commissioner likewise disregarded the transfers in determining the capital gain realized by taxpayers upon the 1940 liquidation distribution, and included in their gross incomes for that year the gain attributable to the number of shares orginally held by them, resulting in the 1940 deficencies in controversy. (R. 16, 29.) The Tax Court concluded that the alleged gifts were not bona fide (R. 87), that taxpayers did not intend to relinquish dominion and control over the trans-

ferred shares (R. 88, 89), and sustained the Commissioner's deficiency determinations (R. 90).

After the Tax Court's opinion was promulgated, and on August 17, 1945, taxpayers filed a "Motion for Rehearing and Reconsideration." (R. 91–100.) This motion was granted insofar as it requested modifications in certain particulars of the Tax Court's findings of fact and in all other respects was denied. (R. 100–102.) Thereafter, on November 19, 1945, taxpayers filed a "Motion for Special Leave To File Motion for Further Hearing and Reconsideration" (R. 102–117), which was denied (R. 118).

The Circuit Court of Appeals affirmed (R. 139–145), and taxpayers' petition for rehearing was denied (R. 147).

ARGUMENT

1. The decision below is in accord with the established principle that a donor who retains command or other economic benefits of ownership of the donated property remains its real owner for purposes of Section 22 (a) of the Internal Revenue Code, *supra*. *Commissioner* v. *Sunnen*, No. 227, decided by this Court April 5, 1948, not yet reported; *Commissioner* v. *Tower*, 327 U. S. 280; *Helvering* v. *Clifford*, 309 U. S. 331; *Corliss* v. *Bowers*, 281 U. S. 376. It is immaterial whether the gift is made in trust (*Helvering* v. *Clifford, supra; Corliss* v. *Bowers, supra*) or, as in this case, directly to the donee (*Commis-*

sioner v. *Sunnen, supra; Commissioner* v. *Tower, supra; Gouldman* v. *Commissioner,* 165 F. 2d 686 (C. C. A. 4th); *Overton* v. *Commissioner,* 162 F. 2d 155 (C. C. A. 2d); *Coffey* v. *Commissioner,* 141 F. 2d 204 (C. C. A. 5th)). Nothing in the controlling decisions warrants the view, upon which the petition for certiorari is founded, that the broad definition of gross income contained in Section 22 (a) is to be circumscribed by refinements of legal title or by local law concepts of ownership; in that section Congress exercised to the full measure its constitutional power to tax income. *Helvering* v. *Clifford, supra,* p. 334; *Helvering* v. *Stuart,* 317 U. S. 154, 169; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *Irwin* v. *Gavit,* 268 U. S. 161, 166. Indeed where, as here, we are dealing with intra-family transfers, "special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as § 22 (a) is concerned." *Helvering* v. *Clifford, supra,* p. 335. See also *Commissioner* v. *Tower, supra,* pp. 287–288.

The record unquestionably justifies the Tax Court's conclusion (R. 87, 88–89), sustaining the Commissioner's determination, that taxpayers remained the substantial owners during the taxable years of the portions of the stock holdings which they purported, by a series of simultaneous criss-cross transfers, to give to their respective wives

and children. The stock certificates were never delivered to the donees; although taxpayers purported to transfer most of their stock interest they continued, as before, to exercise all the rights of controlling stockholders; shortly after each transfer they caused the corporation to declare substantial dividends which they immediately "borrowed" from the donees and appropriated to their own use; demand notes executed by them for the borrowed dividends were never delivered to the donees, and neither interest nor principal on these notes was ever paid; the shares placed in the children's names were later reacquired for the purpose of liquidating the corporation and enabling taxpayers to form a partnership with their wives; demand notes executed for the reacquired shares, like those executed for the dividends, were not delivered and remained unpaid; taxpayers later ordered destruction of all the notes and substitution of others payable to a trustee, and then countermanded this order on advice of their attorney. (R. 80–87.) Any one of the foregoing features—which are uncontroverted—furnishes solid evidentiary support for the Tax Court's inference that the gifts were not "bona fide" (R. 87) and that taxpayers did not intend to "relinquish dominion and control" over the donated shares (R. 88). When they are viewed in combination the evidentiary basis for the Tax Court's conclusion is unassailable. Under familiar rules governing the scope of judicial

review of Tax Court decisions, affirmance of the Tax Court's decision by the court below was clearly correct. To permit the tax consequences here to turn upon the paper maneuvers employed by taxpayers would sanction a type of formalism which the courts have repeatedly refused to recognize as effectual to alter tax liability.[3]

2. The decision below is not in conflict with applicable decisions of this Court or of any of the Circuit Courts of Appeals. Taxpayers' reliance (Pet. 11–12) upon *Blair* v. *Commissioner*, 300 U. S. 5; *Freuler* v. *Helvering*, 291 U. S. 35; and *Sharp* v. *Commissioner*, 303 U. S. 624, is misplaced. These cases furnish no authority whatever for their assumption that the validity of a gift under state law precludes taxability of the donor under Section 22 (a).[4] They presented

[3] This case is a much stronger one than the *Clifford* case for treating the donor as substantial owner for purposes of Section 22 (a). In that case it was stipulated (p. 333) that the income from the donated stock was used by the donee-wife for the benefit of herself and the children; taxpayers here continued to enjoy use of the income (as well as control over the income-producing stock) by "borrowing" the dividends (R. 81–84) and applying them to their own use (R. 84, 89). What is more, taxpayers did not even purport to act in a fiduciary capacity in exercising control over the donated stock, as did the donor in the *Clifford* case.

[4] The "state law" upon which taxpayers rely (Pet. 2–3, 8, 9) consists of a declaratory judgment by the Superior Court of Cook County, Illinois, obtained in proceedings commenced after the Tax Court's opinion was promulgated (R. 102, 113). Four months after the filing of the opinion taxpayers filed a "Motion for Special Leave" (R. 102–117) to reopen the proceedings on the basis of the state court decree.

situations in which a settlor had parted with substantial (as well as titular) ownership of a trust fund, and arose under the statutory provisions dealing with the taxability of trust income to the trustee vis-a-vis the beneficiaries.[5] They turned upon local law merely for purposes of construction of the trust instrument. Thus in the *Blair* case local law was held (pp. 10–11) determinative of the power of the beneficiary to assign his interest; in the *Freuler* case it was held (pp. 43–45) determinative of the distributive rights of the beneficiaries; and the *Sharp* case, involving the question whether certain property belonged to a decedent's estate or a trust created by him, was decided *per curiam* on the basis of the *Blair* and

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No reason appears why the proceedings could not have been instituted and the decree obtained "in ample time to present it before the Board [now the Tax Court] had made and filed its findings of fact and opinion." *Bankers Coal Co.* v. *Burnet*, 287 U. S. 308, 313. At any rate, even if the state court decree had antedated the Tax Court's opinion, it would not have been controlling for federal income tax purposes. *Doll* v. *Commissioner*, 149 F. 2d 239 (C. C. A. 8th), certiorari denied, 326 U. S. 725; *Sewell* v. *Commissioner*, 151 F. 2d 765 (C. C. A. 5th), certiorari denied, 327 U. S. 783); *Loggie* v. *Thomas*, 152 F. 2d 636 (C. C. A. 5th); *Eisenberg* v. *Commissioner*, 161 F. 2d 506 (C. C. A. 3d), certiorari denied, 332 U. S. 767.

[5] Sections 161 and 162 of the Internal Revenue Code (26 U. S. C. 161, 162), and corresponding sections of the prior Revenue Acts. "These provisions have appropriate reference to cases where the income of the trust is no longer to be regarded as that of the settlor." *Douglas* v. *Willcuts*, *supra*, p. 10. See also *Harrison* v. *Schaffner*, 312 U. S. 579.

Freuler decisions.[6] The Circuit Courts of Appeals cases upon which taxpayers chiefly rely for conflict (Pet. 9–10) are of the same nature and involved issues equally far removed from that here presented.

As for the cases relied upon by taxpayers (Pet. 12–13) which do deal with the question here presented, they turn as they must on their own facts and present no conflict. *Marshall* v. *Commissioner*, 57 F. 2d 633, certiorari denied, 287 U. S. 621, and *Bardach* v. *Commissioner*, 90 F. 2d 323, decided by the Circuit Court of Appeals for the Sixth Circuit, antedated the *Clifford* and related cases, and are to be contrasted with later decisions of the same court in cases bearing a closer factual resemblance to the one at hand.[7] *Lawton* v. *Com-*

[6] In *Helvering* v. *Stuart*, *supra*, pp. 161–162, this Court cited the *Blair* and *Freuler* cases for the proposition that "The power to transfer or distribute assets of a trust is essentially a matter of local law," and proceeded to observe (p. 162) that "Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability." Far from departing from the familiar doctrine that command over property or its income marks the owner for purposes of Section 22 (a), this Court (p. 169) remanded the *John Stuart* case to the Tax Court for the purpose of determining whether the taxpayer-grantor remained the substantial owner under the principles enunciated in the *Clifford* case.

[7] See, *e. g.*, *Dawson* v. *Commissioner*, 163 F. 2d 664 (C. C. A. 6th); *Lowry* v. *Commissioner*, 154 F. 2d 448 (C. C. A. 6th), certiorari denied, 329 U. S. 725; *Miller* v. *Commissioner*, 147 F. 2d 189 (C. C. A. 6th). In *Seifert* v. *Commissioner*, 157 F. 2d 719 (C. C. A. 2d), the court expressly refused to con-

missioner, 164 F. 2d 380, decided by the same court, is patently distinguishable on its facts. *Plimpton* v. *Commissioner,* 135 F. 2d 482 (C. C. A. 1st), was distinguished by the very court which decided it in *Emery* v. *Commissioner,* 156 F. 2d 728, 731–732, certiorari denied, 329 U. S. 772, on grounds which also distinguish it from this case. And *Richardson* v. *Smith,* 102 F. 2d 697 (C. C. A. 2d), confirms rather than impugns the correctness of the decision below.

CONCLUSION

The decision below is correct. There is no conflict, and no occasion for further review. The petition should therefore be denied.

Respectfully submitted.

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sider the *Marshall* case as authority on the tax effect of intra-family gifts.

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